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IN THE

Supreme Court of the United States

October Term, 1971

Docket No. 71 - 421

TEXAS GULF SULPHUR COMPANY and CHARLES F. FOGARTY,
Petitioners,

against

WALTER A. MITCHELL,
Respondent.

TEXAS GULF SULPHUR COMPANY and CHARLES F. FOGARTY,
Petitioners,

against

GEORGE GORDON REYNOLDS,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

To the Honorable Warren E. Burger, Chief Justice, and the Honorable Associate Justices of the Supreme Court of the United States:

Your petitioners, Texas Gulf Sulphur Company and Charles F. Fogarty, respectfully pray that a writ of certiorari issue to review the judgment of the United States

Court of Appeals for the Tenth Circuit entered in this proceeding on April 26, 1971. The decision below is based largely on language in the Second Circuit opinion in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Company*, in which petitions seeking review in this Court have been filed by these petitioners and others (Nos. 327, 328, 346, 347).

Opinions Below

The opinion of the United States District Court for the District of Utah (Ritter, J.) is reported at 309 F. Supp. 548 and at page 1a.* The opinion of Circuit Judge Hill for the Tenth Circuit Court of Appeals, not yet officially reported, appears at page 40a.

Jurisdiction

The judgments of the Court of Appeals were entered on April 26, 1971. A timely petition for rehearing by respondents was denied on September 10, 1971, and this petition for certiorari was filed within ninety days of the latter date. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

Questions Presented

1. Whether a corporate press release warning against false and extravagant rumors concerning operations of the company was issued "in connection with the purchase or sale of any security" (thereby coming within the ambit of Section 10(b) of the Securities Exchange Act of 1934 and

* References in this form are to the Appendix annexed hereto.

Rule 10b-5 thereunder) when neither the company nor those who prepared the release were buying or selling its securities and did not intend, expect or receive any advantage from the release?

2. Whether, without proof of intent to deceive, a company and its officers should be held liable under the statute and rule in damages for a press release which expressed the good faith opinion of responsible corporate management with respect to preliminary evaluation of a mineral prospect and which promised a detailed statement "as soon as reasonable and logical conclusions can be made"?

3. Whether, on the facts at bar, a private cause of action should be implied from a rule promulgated by an administrative agency, when such an implication is contrary to the legislative scheme and when to do so will discourage the disclosure of information to the public and thus thwart one of the principal goals of the securities laws?

4. Whether, when neither fraud nor reckless conduct was shown, the First Amendment rights of petitioners to comment on a matter of public interest were abridged by the decision below?

5. Whether, when the company issued a second press release which was relayed to every brokerage house in the country and which provided detailed information regarding an ore discovery, persons who sold the company's stock after the second release had been received by their brokers should be permitted to recover hypothetical additional

profits from the company based upon their own testimony that their sales were prompted by a prior release which had not provided detailed information but which had promised the second release?

6. What measure of damages should be awarded a seller claiming lost speculative profits where the stock is traded on a national exchange and numerous factors have been responsible for a large increase in market price?

7. Whether, if a showing of fraud is not required for the imposition of liability in damages under Rule 10b-5, the statute of limitations to be applied should, nevertheless, be based on state fraud provisions rather than state blue-sky or other statutes which contain similar substantive language?

8. Whether, under the provisions of Section 27 of the Securities Exchange Act of 1934, there is jurisdiction in the District of Utah over the person of a corporate official who is not found, is not an inhabitant, and transacts no business in the district, and whose sole act was, as part of his duties with a corporation, to draft a press release in New York, reports of which were subsequently disseminated by the news media throughout the United States including Utah.

Statutes and Rule Involved

48 Stat. 891, 902; 15 U.S.C. §§78j(b), 78aa are set forth at pages 75a-76a of Appendix B to this Petition.

17 C.F.R. §240.10b-5 is set forth at page 76a of Appendix B to this Petition.

Statement of the Case

A. Introductory Statement

These actions arose out of the issuance of a press release on April 12, 1964 by Texas Gulf Sulphur Company ("Texas Gulf") commenting on published rumors concerning its mineral exploration activities near Timmins, Ontario, Canada. While the monetary amounts involved in these actions are not large, the legal principles and impact of this case are of great significance. The decisions below, for the first time, apply to a private damage action the legal conclusions reached by the Second Circuit in *SEC* v. *Texas Gulf Sulphur Company,* 401 F.2d 833 (2d Cir. 1968) (the "SEC action"). They mark the culmination of a process whereby private causes of action, not granted by Congress when it created certain private causes of action under the Securities Exchange Act, have been judicially implied for violation of a rule promulgated by an administrative agency.

While the *SEC* action did not itself involve private claims for damages, Judge Friendly, in a concurring opinion, identified the damage question as one "transcending in public importance all others in this important case". He stated persuasively, from reason and the legislative history, that "the April 12 press release would be the worst possible case for the award of damages" because of its punitive effect on the company's innocent shareholders and its inhibitory effect on dissemination of information "to security holders and the public generally with respect to important business and financial developments" (401 F.2d at 866, 868, 867). Judge Friendly went on to point out that the Rule, at least as later construed by the Tenth

Circuit herein, might well be beyond the authority vested in the SEC by §10(b) and be so inconsistent with the statutory structure as to be impermissible (401 F.2d at 868).

Moreover, while the present actions involve only two plaintiffs, a class action is pending in the Southern District of New York based on similar allegations on behalf of all sellers of Texas Gulf Stock after issuance of the April 12 release and before publication of a second release announcing a major discovery. See *Cannon* v. *Texas Gulf Sulphur Co.*, 47 F.R.D. 60 (S.D.N.Y. 1969). As the Court of Appeals below noted, if damages were to be awarded in that action on the basis of the principles adopted below, the recovery would amount to millions of dollars (66a-67a). Yet in neither the *SEC* action nor this action was any evidence adduced of any intentional wrongdoing in connection with the press release or of any economic benefit to the corporation, its stockholders or its employees from its issuance. As Judge Friendly stated, to award damages in this context is "frightening", not only for Texas Gulf, but for all publicly held corporations. 401 F.2d at 866.

The questions presented by this petition and the companion petitions in the *SEC* action raise important and far-reaching questions under the securities laws concerning disclosure of information relating to corporate activities, questions upon which this Court has not yet passed. The decisions below run counter to a basic purpose of those laws, and should now be reviewed by this Court. Judge Friendly believed it incumbent upon the Second Circuit to give guidance to the district courts upon these problems (401 F.2d at 866), but that court failed to do so. It is now imperative that such guidance be supplied by this Court.

B. The Proceedings Below

Respondents Reynolds and Mitchell instituted actions in the Utah District Court against petitioners on July 12, 1966, and April 17, 1967, respectively. They sought to recover damages upon sales of stock allegedly induced by violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) (the "1934 Act") and Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder. Jurisdiction of the District Court was invoked under Section 27 of the 1934 Act, 15 U.S.C. §78aa.

The press release of April 12, 1964, of which respondents complain, was followed four days later on the morning of April 16 by a second release announcing a major mineral discovery. Respondent Reynolds sold TGS stock on April 16, and respondent Mitchell on April 17 and April 23, all sales taking place *after* the second release had been received by their brokers and after a sharp rise in the price of Texas Gulf stock. Both respondents claimed, however, that their sales were caused by and made in reliance upon the earlier (April 12) press release and that their shares were sold to petitioner Fogarty.

The actions were consolidated (with two other actions not involved in this petition) and tried before the court without a jury. Judgments were awarded to respondents, and on appeal the judgment in favor of Reynolds was affirmed in all respects except as to the issue of damages; the judgment in favor of Mitchell was affirmed in all respects except as to damages and as to his sale of 20 shares of stock. The Court of Appeals ordered that the cases be remanded with directions to enter judgment in higher

amounts, for Reynolds in the amount of $12,687.50, and to Mitchell for $7,600.00, both to receive interest on those amounts from the dates of their sales in April of 1964.

C. The Facts

The evidence was uncontradicted that the April 12 press release was issued because of the front page appearance in the New York newspapers on Saturday, April 11, 1964, of false statements concerning Texas Gulf's drilling activities, and rumors that Texas Gulf and an alleged partner had made "the biggest ore strike since gold was discovered more than 60 years ago in Canada," a "sensational copper strike" and similar superlatives. After consultation among President Stephens, Executive Vice President Fogarty and the company's public relations consultant, it was concluded that TGS should promptly put out a press release in response to the rumors. A draft of the release was prepared on Saturday and Sunday by Dr. Fogarty, after telephone conversations and meetings with Richard D. Mollison, the Texas Gulf vice president in direct charge of the project who had been on the property the previous day, April 10. Mollison supplied the available information and with that, Fogarty prepared the first draft of the release. It was put in final form by Texas Gulf's public relations consultant and, after Dr. Fogarty had conferred with President Stephens and a Texas Gulf attorney, President Stephens authorized its issuance (43a-44a).

The Court of Appeals recognized that at the time the press release was drafted "[t]he president, a vice president and Fogarty all agreed that they could not responsibly conclude that a commercial ore body existed and that no

calculations as to the size or grade of ore could be made without further drilling" (44a). This conclusion was concurred in by the eminent mining experts called by defendants at trial. In these circumstances, Texas Gulf chose to issue a statement which did not set forth detailed drilling information, but rather rebutted the falsehoods and warned of the exaggerations. It not only stated that the work done to date had "not been sufficient to reach definite conclusions and any statement as to size and grade of ore would be premature and possibly misleading," but also promised that when Texas Gulf had "progressed to the point where reasonable and logical conclusions can be made, TGS will issue a definite statement to its stockholders and to the public in order to clarify the Timmins project" (44a-45a, n.5).

The April 12 release was reported on in several newspapers, including the *Wall Street Journal,* on Monday morning, April 13, and by the Dow-Jones news service. On that day, TGS stock closed at $30⅞, 75 cents above its closing price the previous trading day, April 10.

On Sunday, April 12, contemporaneously with the issuance of the release, Texas Gulf sent the officials in charge of its exploration team back to Timmins from New York. A fourth drilling rig was put into operation—until April 8 only one had been able to operate because of a shortage of water—and the drilling progress was accelerating. By the afternoon of Wednesday, April 15, four more holes had been completed to add to the three which had been completed by April 10, and twice as much footage had been drilled as

on the 10th. Moreover, the holes covered a much larger area, giving meaningful results on April 15 over a space four times as large as had been drilled on April 10. Thus, on April 16, TGS was able to issue the definite statement promised by the April 12 release; this release commenced with the statement that TGS "has made a major discovery of zinc, copper and silver in the Timmins area of Ontario, Canada."

The second release was carried over the private wire of Reynolds' broker, Merrill Lynch, and received in Salt Lake City at 8:29 A.M., M.S.T., on April 16. The Dow-Jones news service also carried the story to the brokerage houses in Utah at 8:55 A.M., M.S.T., and the April 16 press release received wide coverage in newspapers throughout the country (46a).

Respondent Reynolds, a Salt Lake City resident, testified that after he had read reports of the April 12 release on Monday, April 13, and discussed them with his broker, he decided not to sell but instead to "hold the stock, see what happened." He gave his order to sell only after his Merrill Lynch representative had called him on the morning of April 16, *after* the reports of the April 16 release had been conveyed to Merrill Lynch in Salt Lake City, and *after* he had been informed by his broker that "there's a rumor that Texas Gulf has made a big strike." Reynolds' stock was sold for $33\frac{5}{8}$ per share at 9:31 A.M., M.S.T., an hour after the Merrill Lynch wire had been received in Salt Lake City (20a-21a).

Respondent Mitchell, a Los Angeles resident, who made a habit of coming into his broker's office "almost daily"

and reading the "Dow-Jones broad tape," nevertheless testified that he first learned of the *April 12* release on April 16 at 9:30 A.M., P.S.T. at his broker's office. This was 1½ hours *after* news of the *April 16* release had there been received, posted, and generally made available to the customers. Mitchell saw the hectic trading and rise in price in TGS stock that morning, returned to his office and reviewed his TGS file, and then went to the offices of another broker and placed an unsolicited order for the sale of 400 shares of TGS stock. This was no ordinary sale order: rather it was an order for a short sale against the box at $40.00 per share, although at the time this order was entered, the stock was trading at $34½ to $34¾. The stock was sold on the next day, April 17, for $40, $10 above the price before the April 12 release was issued. Subsequently, Mitchell placed another order for a short sale against the box at a price of $45.00 per share, and the shares were actually sold on April 23 for $46¼. He nevertheless asserted that his sales orders, placed substantially above the market, were made in reliance upon and induced by the earlier April 12 release (23a-24a).

D. The Decisions Below

These actions were tried April 29 through May 2, 1968. More than sixteen months later, on September 11, 1969, and after the intervening decision of the Second Circuit in the *SEC* action, Judge Ritter announced his decision in favor of respondents. An opinion was filed on October 17, 1969, and a revised opinion, along with amended findings of fact and conclusions of law, was filed on January 9, 1970.

In his revised opinion, Judge Ritter held that both Texas Gulf and Dr. Fogarty had violated §10(b) and Rule 10b-5 in issuing the press release. However, he rejected respondents' charges that the release was the product of a conspiracy to depress the price of the stock for the benefit of petitioners, that it was issued for the purpose of enabling certain persons, including petitioners, to purchase shares of TGS stock cheaply, and that Dr. Fogarty had purchased respondents' stock. Judge Ritter said, however, that the press release was "inaccurate, misleading and deceptive with respect to material matters disclosed by the company's drilling near Timmins," and added in his opinion (although not in the findings) that "the court thinks designedly so" (21a, 25a). No evidentiary support nor any basis for the last statement was cited, and none exists in the record.

The District Court further held that despite the fact that the sales had taken place *after* dissemination of the second press release of April 16, 1964, respondents had relied on the first release in making their sales. Damages were awarded based on a measure of the difference between their sales prices and the average of the highest daily prices of Texas Gulf stock for a month (twenty trading days) after the April 16 announcement.

On appeal the Court of Appeals affirmed, relying heavily, as had the District Court, on the opinion of the Second Circuit in the *SEC* action. The Court of Appeals found that the general language of Rule 10b-5 prohibited the "wait and see" release of April 12, *i.e.*, that when Texas Gulf and Fogarty "undertook to deny and clarify rumor and fact, they were bound to accurately depict the situation as they then knew it" (53a). Moreover, although the

court recognized that the principal officers of Texas Gulf in charge of the exploration "could not responsibly conclude that a commercial ore body existed and no * * * calculation as to size or grade of ore could be made without further drilling," nevertheless it held that a statement to that effect was not legally sufficient and that Texas Gulf was required to set forth "the then known dimensions and drilling data of their discovery" (44a, 53a). The Tenth Circuit further held that the press release was issued "in connection with" the purchase and sale of securities, although there had been no showing that either the corporation or any insiders were in the market for stock and no showing that the press release was designed to affect the market price of Texas Gulf stock for the benefit of the corporation or any insiders.

The Tenth Circuit apparently found no basis for the District Court's unsupported speculation that the press release was "intentionally deceptive * * * and knowingly deficient." However, undeterred by this lack of evidentiary support, the Tenth Circuit simply switched the burden of proof on this issue to defendants, and held that "[c]onfronted with the abundance of evidence in the record,"* it could not be concluded that Texas Gulf had "sustained its burden of proving that it did not know of the misrepresentation" (61a).

As to respondents' supposed "reliance," the Tenth Circuit stated that "the evidence is not so deficient as to make the finding of the trial court clearly erroneous that the principal reliance was on the April 12 statement" (62a). However, the court felt that the issuance of the April 16 release

* What this "abundance of evidence" consisted of was never explicitly stated and the record will be searched in vain for any evidence of bad faith or intentional deception.

should bar recovery for sales made "at some point in time after [its] publication" (63a). Despite the "abundance of publicity given the April 16 statement" and the massive trading immediately after its dissemination, the court felt that only claims made on sales after April 20 (including one involving 20 shares by respondent Mitchell on April 23) should be barred from recovery.

With respect to damages, the Court of Appeals, admittedly fashioning a new rule, held that respondents should be permitted to recover the difference between the prices for which their shares were sold and the highest value between April 20 (*i.e.*, the date when, the court speculated, "the diligent and reasonable investor was informed of the most recent Texas Gulf statement") and a date ending the period within which, after being informed, the reasonable investor is to be permitted "to decide whether or not he would reinvest and take advantage of a spiraling market" (67a). This measure of damages led to an increase of approximately 50% in the awards to Reynolds and Mitchell over the amounts ordered by the District Court, which were based on the average high prices for the stock over a period of one month.

Reasons for Allowance of the Writ

1. The Tenth Circuit has decided questions of federal substantive law under the securities laws which are of great importance and wide application to all corporations whose stock is publicly traded, to their shareholders, and to the public generally, and which should be settled by this Court. In particular, the Tenth Circuit, in an unprecedented decision, has held that a corporation, which

chooses to issue a press release in good faith and without ulterior purpose in response to false and exaggerated published rumors, can be held liable in damages to sellers of stock who claim to have been discouraged thereby. This holding makes the corporation's present shareholders insurers for the hypothetical profits of former shareholders. The decision, if permitted to stand, will inhibit disclosure of information about corporate activities where no statement is legally required and thus frustrate, not further, one of the principal goals of the securities laws.

2. The decision below is inconsistent with the express provisions of the 1933 and 1934 Acts establishing private causes of action since it permits recovery of damages in the absence of an affirmative showing of fraud and of petitioners' involvement in securities transactions.

3. The decision below is in conflict with rulings of the Second Circuit that damages may not be awarded in private actions under Rule 10b-5 without proof of *scienter*. The decision also violates petitioners' rights under the First Amendment.

4. In conflict with a decision of the Eighth Circuit Court of Appeals, the Tenth Circuit has held, despite its holding that plaintiffs need not demonstrate fraud to recover, that the "most nearly analogous" statute of limitations is the state fraud statute, rather than the state "blue-sky" provision which contains language similar to Rule 10b-5.

5. The Court of Appeals has, in conflict with decisions of this Court, sustained jurisdiction over the individual petitioner despite the lack of evidence that he had any purposeful connection with the state in which the district lies.

ARGUMENT

I

The Court of Appeals, in awarding damages against petitioners for good faith issuance of a press release, found to be defective for failure to conform to standards first enunciated in this litigation, has contravened all prior precedent and legislative history and has rendered a decision in conflict with the basic structure and purpose of the securities laws.

A. The press release was not issued "in connection with" the purchase or sale of securities simply because it was issued by a company whose stock is publicly traded.

Section 10(b) of the 1934 Act was designed by Congress to enable the Securities and Exchange Commission to deal with manipulative or deceptive devices integrally related to transactions in securities, not to serve as the basis for regulating corporate comment which is unrelated to securities transactions. Certain aspects of corporate disclosure were dealt with specifically in the 1934 Act in Sections 12, 14, 16(a), 18 and 32, and disclosure by registration statement and prospectus was the subject of the 1933 Act. Section 10(b), on the other hand, was meant to be a supplement to the specific prohibitions against manipulation by traders and other market professionals contained in Sections 9 and 10(a) of the 1934 Act as the legislative history clearly demonstrates. One of the principal draftsmen of the 1934 Act testified:

> "Subsection [b] says, 'Thou shalt not devise any other cunning devices' * * * Of course subsection [b] is a

> catch-all clause to prevent manipulative devices. I do not think there is any objection to that kind of a clause. The Commission should have the authority to deal with new manipulative devices." Testimony of Thomas G. Corcoran, *Hearings on H.R. 7852 and H.R. 8720 before the House Committee on Interstate and Foreign Commerce,* 73d Cong., 2d Sess. 115 (1934).

The manipulative devices outlawed by Section 9 all involve fraudulent activities integrally related to securities transactions: matched orders, pools, wash sales and the like. In enacting §10(b), as well as the other antifraud provisions of the securities laws—Sections 12(2) and 17(a) of the 1933 Act and Section 15(c)(1) of the 1934 Act—Congress' concern was to enable the SEC to deal with purposeful schemes by purchasers or sellers to defraud the public by means of manipulative and deceptive devices. No such activity was involved here.

The case law, prior to the *SEC* action, was in accord with this legislative purpose. Satisfaction of the "in connection with" requirement, it was repeatedly held, required a showing by plaintiff that defendant had either (1) engaged in fraud as a party to a securities transaction, or (2) engaged in fraud to induce plaintiff to purchase or sell securities. See 401 F.2d at 886 (Moore, J., dissenting).

The present case follows the decision of the Second Circuit in abandoning these requirements. However, in a concurring opinion in that case, Judge Friendly stated that "the April 12 press release would be the worst possible case for the award of damages" and that the consequences of imposing civil liability on a corporation in these circumstances were "frightening" (401 F.2d at 868, 866).

Judge Friendly's "worst possible case" has now come to pass.

B. The unrestricted liability for damages imposed by the court below is in conflict with the legislative history and policy of the securities laws.

Those sections of both the 1933 and 1934 Acts creating private causes of action were carefully drawn to accomplish two purposes: "the protection of the public [and] * * * the least possible interference to honest business." H.R. Rep. No. 85, 73d Cong., 1st Sess. 5 (1933). Thus, where private damage suits were specifically authorized under the securities laws, Congress carefully provided appropriate restrictions upon the right of action—privity, short statutes of limitation, *scienter,* causation and undertakings for costs (*e.g.,* 3 Loss, SECURITIES REGULATION 1765, 1778, *et seq.*)—so that honest businesmen, acting in good faith, would not be subject to threats of harassing lawsuits and enormous judgments.

The Tenth Circuit, however, in following cases under Section 12(2) of the 1933 Act (*e.g., Gilbert* v. *Nixon,* 429 F.2d 348 (10th Cir. 1970)) and concluding that the burden of proof on the *scienter* issue should be placed on defendants,* has disregarded Congressional limitations and has upset the balance between protecting the public, on the one hand, and responsible businessmen, on the other. Section 12(2)—which gives to a purchaser of securities a right to sue the seller—has several explicit restrictions built into the statute which are not present in Rule

* Such a result had never before been reached and is diametrically opposed to the prevailing rule in the Second Circuit. *Fischman* v. *Raytheon Mfg. Co.,* 188 F.2d 783 (2d Cir. 1951); *Shemtob* v. *Shearson, Hammill & Co., Inc.,* No. 71-1504 (2d Cir., August 31, 1971).

10b-5, such as the requirement that the defendant be the seller of securities and thus the person who profited from misstatements; a short statute of limitations, Section 13 of the 1933 Act, and provision for security for costs, Section 11(e). The privity requirement of Section 12(2) is particularly significant because the decision below holds Texas Gulf liable to sellers of its securities, even though Texas Gulf did not buy or sell securities and was not enriched in any degree.

In comparing civil liability under the 1933 and 1934 Acts, Professor Loss has remarked:

> "* * * the express civil liabilities under this Act (the 1934 Act) are much less rigorous than those under the 1933 Act—reflecting a watering down of the original draft in the light of the expressed fears that corporate managements would 'strike' against listing their securities on exchanges and putting their heads into the lion's mouth. * * *" 3 Loss, SECURITIES REGULATION 1746-1747 (1961).

The legislative scheme thus does not contemplate the imposition by implication of standards of responsibility under Section 10(b) and Rule 10b-5 which are far more strict than those imposed under the express provisions of the 1933 Act. In commenting on anomalous results similar to that reached by the court below, Loss states that this Court may be persuaded "to throw its collective hands *up* and the [implied private liability] doctrine out." 3 Loss, SECURITIES REGULATION 1790 (1961). No such action, however, is required to reverse the decision below; to restore some reason to the law, this Court need only hold that "fraud" means at least knowledgeable wrongdoing and that the requirement that the act complained of be "in con-

nection with the purchase or sale of securities'' means at least that the wrongdoing must be integrally related to a securities transaction. These common-sense propositions are what the statute and rule say, and they constituted the law prior to this and the *SEC* action.

In addition to the specific legislative history, the general policy behind the securities laws requires reversal of the result reached by the Tenth Circuit. Prior to initiation of its suit against Texas Gulf, the SEC referred to the ''commendable and growing recognition on the part of industry and the investment community of the importance of informing security holders and the public generally with respect to important business and financial developments.'' Securities Act Release No. 3844 (October 8, 1957). Such disclosure can hardly be promoted by a rule of law that voluntary, good faith, corporate statements not connected with securities transactions and issued only to warn the public against false and extravagant rumors will expose a company to damage suits from all claiming to have been misled thereby.

C. The standards enunciated by the Tenth Circuit, which ignore altogether the good faith judgment of Texas Gulf's management, place an impossible burden of compliance on corporations and will inhibit disclosure of business information.

Not only did the Tenth Circuit create a liability which did not exist before, but it formulated standards for press releases which are not intimated in the statute or rule. And, in giving these standards *ex post facto* application, it held that failure to comply with those newly devised

standards constituted "fraud." But Texas Gulf made no false statements, nor did it purport to set forth any statement at all as to what had been found by the drilling at Timmins. The release merely warned against accepting rumor as fact and promised a further statement "when reasonable and logical conclusions can be made." The good faith determination of Texas Gulf officials that such conclusions could not then be made was supported at trial by the testimony of four eminent mining experts.

However, the Tenth Circuit held that the release was insufficient and misleading as a matter of law; that Rule 10b-5 required Texas Gulf to set forth the drilling data it then had; *i.e.*, "to unveil the then known dimensions and drilling data of their discovery" (53a). Yet at the time Texas Gulf spoke, and indeed to this day, no rule or regulation of the SEC has ever required or even suggested that disclosure of preliminary drilling data should be made in documents filed with that agency. To the contrary, the whole thrust of enforcement under the securities laws has been to discourage disclosure of preliminary data. See, *e.g., Item 8A(b) of Schedule I to Form 1-A relating to Regulation A offerings under the Securities Act of 1933,* 1 CCH Fed. Sec. L. Rep. ¶7327 (77a).

The Tenth Circuit recognized that the honest opinion of the management of Texas Gulf, consisting of several mining engineers and geologists, was that at the time the release was issued, the available drilling data was not yet sufficient to reach responsible conclusions (44a); in those circumstances, it can hardly be "fraud" for management to conclude that the disclosure of such prelimi-

nary and inconclusive data was neither necessary nor desirable. The interpretation and application of Rule 10b-5 in this case goes beyond the authority granted by §10(b) of the 1934 Act.

The scrutiny of the press release by the Tenth Circuit was more appropriate to review of a registration statement or prospectus than a press release. Not only are the former documents prepared with painstaking care over long periods of time to conform with precise rules, regulations and schedules promulgated by the SEC, but they are also documents designed to elicit funds for the benefit of the issuer. Here the press release was drafted under great pressure on a weekend to respond to extravagant rumors in a situation where no guidelines existed; furthermore it was not designed to obtain any economic benefit for the corporation or its officers.

Moreover, Texas Gulf's right to comment upon matters of public interest to its shareholders is protected by the First Amendment. As discussed in the companion petition in the *SEC* action (No. 327, at pp. 27-30), imposition of liability upon Texas Gulf in these circumstances violates basic constitutional rights.

In sum, the effect of the present decision is that Texas Gulf, acting in good faith and without any ulterior purpose, has been judged in hindsight under newly-created, court-made rules which go beyond the statute and indeed contradict legal precedents and administrative practice under the securities laws, and having been so judged, is now required to account, perhaps to thousands of persons, for paper profits to which those persons have been encouraged to feel entitled.

II

The Tenth Circuit compounded the effect of its erroneous decision on the scope of Rule 10b-5 by permitting recovery by persons who sold after the issuance of a second release announcing a major ore discovery and by fashioning a rule of damages which requires innocent shareholders to pay large sums to those who have not been damaged.

Not only did the Tenth Circuit determine that Texas Gulf could be liable to all sellers of its stock because of its April 12 release, but it also concluded that such liability should extend to persons who sold after the promulgation and receipt in brokerage houses and elsewhere throughout the country of a second release announcing a major ore discovery. This result places an enormous burden on publicly-held companies which have thousands of shares traded on the exchanges every day, and ignores both the realities of the situation and case law.

The realities of the situation are clear. The information conveyed by the second release was in the hands of respondents' agents, their stock brokers, before respondents sold; in order to place their sell orders, respondents would have had to call their brokers and presumably would have learned of the second release. Whether they actually learned of that second release or not, notice of the April 16 release delivered to the brokers must be imputed to their customers. *Great American Indemnity Co.* v. *First Nat'l Bank*, 100 F.2d 763 (10th Cir. 1938); RESTATEMENT (SECOND) OF AGENCY, §272 (1957). If the agent fails to inform the principal in such circumstances, the principal is charged with the knowledge of his agent, the principal hav-

ing selected him and confided to him the business at hand. See *Schram* v. *Burt,* 111 F.2d 557, 563-64 (6th Cir. 1940).

Regardless of the question of imputation of the brokers' knowledge to the respondents, Texas Gulf cannot be held responsible for damages after the issuance of the April 16 press release. The issuance of a further statement by the same means by which the first statement was issued puts an end to any possible liability resulting from that first statement. *Vulcan Metals Co.* v. *Simmons Mfg. Co.,* 248 Fed. 853 (2d Cir.), *cert. denied,* 247 U.S. 507 (1918). Similarly, in *Shappirio* v. *Goldberg,* 192 U.S. 232 (1904), this Court held:

> "When the means of knowledge are open and at hand or furnished to the purchaser or his agent and no effort is made to prevent the party from using them, and especially where the purchaser undertakes examination for himself, he will not be heard to say that he has been deceived to his injury by the misrepresentations of the vendor." *Id.* at 241-242.

In *City Nat'l Bank* v. *Vanderboom,* 422 F. 2d 221, 231 (8th Cir.), *cert. denied,* 399 U.S. 905 (1970), the Court of Appeals quoted this language in denying recovery to a seller of stock in a §10(b) action.

The Tenth Circuit's refusal to apply these well-established principles has drastic consequences for a company whose stock is publicly traded. Despite its best efforts to clarify and explain, Texas Gulf can, under the Tenth Circuit's reasoning, be held liable to thousands of selling shareholders who will claim not to have gotten the word, despite its availability in every brokerage office.

Not only did the Court of Appeals permit respondents to recover on the basis of their sales made after dissemi-

nation of the second release, but it awarded damages to them based on the high price of the stock *two weeks* thereafter. In a rapidly rising market, this can mean the imposition of staggering liability on a publicly-held company, in reality, upon its shareholders. The rule has no support in precedent or reason.

Under the federal out-of-pocket rule, which has been held to govern the award of damages in the federal courts since *Smith* v. *Bolles,* 132 U.S. 125 (1889), damages are to be based on the difference between the sale price and the real or actual value at the time of sale. 3 Loss, SECURITIES REGULATION 1629 (1961). At the time of respondents' sales, the information in the April 16 release had been disclosed, and the sharp upward movement of the stock and the heavy trading confirmed that the information had affected the price of the stock. Indeed, before respondent Mitchell sold his stock on April 17, his brokers had stated in an investment letter that the price of the stock reflected the existence of 25,000,000 tons of ore disclosed in the April 16 release.

In any event, there can be no warrant for giving selling stockholders the benefits of increases taking place up to two weeks thereafter.* By that time, other factors, including Texas Gulf's annual meeting and further announcements by Texas Gulf as to the dimensions of the ore body, had intervened, and the price of the stock had increased. The Tenth Circuit justified its harsh rule of damages on the ground that "the wrongdoer is not heard to complain."

* The trial court based its damage award on the average of the high price over a period of one month. TGS stock sold at lower prices for the balance of the month after the date selected by the Court of Appeals. The Court may wish to take judicial notice of the fact that the stock is selling at a much lower price today (after accounting for a three-for-one split).

This rule has its origin and applicability to instances in which the "wrongdoer" profits from the wrong at the expense of the injured party. But the "wrongdoer" who is required to pay is the innocent Texas Gulf shareholder who did not think that the release was ground for selling, but was rather reason either to hold or to buy. Texas Gulf did not profit by issuing the press release. These respondents did not lose money upon their investments, and indeed received more for the stock than they paid for it. The "damages" awarded were additional speculative profits they might have made if they had held on to their stock and sold at some later optimum time. As Judge Friendly predicted, the rule of law enunciated by the Tenth Circuit will simply mean "large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers. * * *" 401 F.2d at 867. With such a possibility looming, a publicly held company is not likely to make a statement which is not legally required, but might well prefer to let the false rumors do their work.

III

The Tenth Circuit decision, in adopting a fraud statute of limitations in an action where there was no finding of fraud, conflicts with a well-reasoned decision of the Eighth Circuit.

Section 10(b) and Rule 10b-5 do not contain any statute of limitations. The right of action under that statute and rule has been implied by the judiciary, and the express statutes of limitation contained in the 1934 Act have not been applied. The federal courts have instead looked to the state limitations period for guidance. Several courts have in the past used the *fraud* provisions of the forum

state as the proper guide in framing a limitations period. Here the District Court held that the Utah three-year fraud statute applied, and the Court of Appeals affirmed.

However, as demonstrated above, the liability of petitioners herein was not predicated upon a finding of fraud, of which there was no evidence in the record; in these circumstances, the claim has become much more like a Blue Sky action than a fraud action. As Professor Loss has stated in his treatise, under the "most nearly analogous test", the statute of limitations period should be that found in the state Blue Sky laws. 6 Loss, SECURITIES REGULATION 3902 (1969). That was the result reached by the Eighth Circuit in *Vanderboom* v. *Sexton,* 422 F.2d 1233 (8th Cir.), *cert. denied,* 400 U.S. 852 (1970). The court there said that the Arkansas Blue Sky provision bore "the closest resemblance to the federal statute involved" and that it was "the most reasonable and logical type of statute to apply to which might be termed an 'implied federal blue sky' type of statutory action." 422 F. 2d at 1237-38. If the Utah Blue Sky provision were adopted,* providing for a two year statute of limitations, both respondent Reynolds and respondent Mitchell would be time-barred.

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* The substantive provisions of Section 61-1-22(1)(b) of the Utah Code closely parallel Rule 10b-5(2):

> "(1) Any person who * * *
>
> "(b) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading * * *."

Section 61-1-22(5) provides in relevant part that "[n]o person may sue under this section more than two years after the contract of sale."

IV

The decisions of the District and Circuit Courts, asserting jurisdiction over petitioner Fogarty, contravene constitutional principles enunciated by this Court.

The courts below have asserted personal jurisdiction over petitioner Fogarty, although there was no evidence that he had any contacts with the state in this matter. The constitutional principle set forth in *Hanson* v. *Denckla,* 357 U.S. 235, 253 (1958), makes it "essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum state, thus invoking the benefits and protections of its laws."

Here, the evidence demonstrated that Dr. Fogarty drafted the press release in his home in Rye, New York, as part of his duties with the corporation. TGS disseminated the release in New York, and reports of it were transmitted from there by the news media, including Dow-Jones, throughout the nation. TGS conducted potash mining activities in Utah and was properly "found" there. However, Dr. Fogarty as an individual was not "found" there and his activities, as above described, do not constitute "purposefully avail[ing] [him]self of the privilege of conducting activities within [Utah]." Thus the District Court's assertion of jurisdiction over him violated the constitutional principles set forth in *Hanson, supra.*

Conclusion

Rule 10b-5, as interpreted by the courts, has been allowed to supplant and upset the legislative scheme enacted by the Congress to balance the investors' need for protection and information with the legitimate requirements of responsible and honest business. The incongruity of an otherwise directed administrative rule supplanting Congressional direction is the product of a process by which the courts have, in case after case, extended Rule 10b-5 just one step further. Professor Loss has warned that "we can't go on indefinitely piling interpretation on interpretation on interpretation." 22 Bus. Law. 921 (1967). The final result, represented by the Tenth Circuit's opinion herein, is a structure built on the quicksand of faultily applied precedent, judicial legislation and misconstruction of the securities laws.

Only this Court can restore a sound foundation based on the provisions of the Rule in the context of the securities legislation enacted by Congress. Rule 10b-5 was promulgated by the SEC to aid its function of preventing fraud by purchasers of securities.* The proper construc-

* In its release announcing the adoption of Rule 10b-5, the Commission stated:

> "The Securities and Exchange Commission today announced the adoption of a rule prohibiting *fraud by any person in connection with the purchase of securities.* The previously existing rules against fraud in the purchase of securities applied only to brokers and dealers. The new rule closes a loophole in the protections against fraud administered by the Commission *by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase.*" Securities Exchange Act Release No. 3230 (May 21, 1942). (Emphasis added.)

See also Freeman, 22 Bus. Lawyer 922 (1967).

tion of the Rule would preclude respondents here, and others with similar claims, from recovering from petitioners and the Texas Gulf shareholders, damages based on the good faith attempt by the company to clarify the status of its rapidly developing exploration at Timmins.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

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September 23, 1971